Department of the
Parliamentary Library

INFORMATION AND RESEARCH SERVICES

Bills Digest

No. 36 2001–02

Taxation Laws Amendment Bill (No. 4) 2001

ISSN 1328-8091

Inquiries

Members, Senators and Parliamentary staff can obtain further information from the Information and Research Services on (02) 6277 2439.

Information and Research Services publications are available on the ParlInfo database.
On the Internet the Department of the Parliamentary Library can be found at:
http://www.aph.gov.au/library/

Published by the Department of the Parliamentary Library, 2001

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 36 2001–02

Taxation Laws Amendment Bill (No. 4) 2001

Chris Field
Law and Bills Digest Group
27 August 2001

Contents

Taxation Laws Amendment Bill (No. 4) 2001

Date Introduced: 28 June 2001

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent, other than Schedule 1 which commences on 1 July 2001. However, the measures have differing application dates which are dealt with in the Main Provisions section.

Purpose

To:

- provide for the conversion of franking credits to reflect the 30% company tax rate
- defer the commencement date for certain changes relating to friendly societies, and
- deny a refund of excess imputation credits for non-complying superannuation funds and approved deposit funds.

Background

As there is no central theme to the Bill the background to the various measures will be discussed below.

Main Provisions

Franking Account

Franking forms part of the dividend imputation system under which resident individuals and certain other institutions, such as superannuation funds, can receive a credit for tax paid by a resident company which pays a dividend. When a resident company pays tax an equivalent amount is credited to its franking account and when dividends are paid there is a debit to the account. Dividends may be unfranked, partly franked or fully franked. In the case of a fully franked dividend the shareholder receives an imputation credit equal to the company tax rate and this can be claimed as a tax rebate or, if there are excess credits (ie credits exceed tax payable) the excess has been refundable since 1 July 2000.

As a result of changing tax rates, companies kept a number of different franking accounts. Prior to 1995-96 companies maintained separate accounts which reflected the company tax rate, class A accounts reflecting the 39% rate, class B reflecting the 33% rate and class C reflecting the 36% rate. Except for a small number of cases, principally life insurance companies, it was required in 1995-96 that all accounts be converted to class C accounts reflecting the current company tax rates. This involved the mathematical conversion of class A and B balances to retain their value relative to the new company tax rate. With the introduction of the 34% tax rate in 2000-01 class C franking accounts were converted to reflect the new rate.

In the Review of Business Taxation (Ralph Report) it was recommended that franking accounts be based on the actual dollar value of tax paid rather than the current system which relies on the company tax rate and the income of the company. Such a change would remove the need for adjustments to franking accounts when the rate of company tax is changed.[1] While it had been anticipated that this change would apply to 2001-02 when the 30% company tax rate was introduced this has not occurred, so that it is necessary to convert the existing class C franking account balances to reflect the new company tax rate.

Schedule 1 of the Bill provides for the conversion of existing franking accounts to the new class C franking accounts. The amendments are of a mathematical nature and deal with the range of franking accounts which can exist in various types of institutions. They all aim to achieve the same result and do not implement any change from previous occasions where there has been such adjustments.

The amendments will apply from 1 July 2001 (**item 11**).

Friendly Societies

Friendly societies are associations originally established for the relief of members in cases of sickness and to assist surviving spouses and children in the case of the death of a member. Their role expanded in the areas in which members could be assisted to included areas such as life insurance, funeral policies and scholarship plans. Members contribute to the society and their entitlements are based not only on their own contributions but also on the society's earnings on the money held. Over time friendly societies have gone from a tax free basis to having the investment income on certain of their products, particularly life insurance, taxed in the same manner as other institutions offering similar products. Member's contributions remain exempt.

The Ralph Report contained a number of recommendations regarding the taxation of life insurance companies and the life insurance business of friendly societies. While many of the measures were implemented from 1 July 2000, the proposal that policyholders be able to receive imputation credits in respect of certain tax paid by the life insurance company or friendly society was not to operate until 1 July 2001. Part of this process involves determining the capital component of a policy so as to be able to determine the investment earning component, and removing the exemption for friendly societies in respect of earnings on income bonds, funeral policies and scholarship plans to bring their taxation into line with similar products offered by other institutions. In a previously unannounced measure, the explanatory memorandum to the Bill states that due to the need for further consultation with industry the commencement date for the above measures will be extended to 1 July 2002.[2]

Paragraph 320-35(1)(f) of the *Income Tax Assessment Act 1997* (ITAA97) provides that investment income relating to funeral plans, scholarship plans and income bonds issued after 30 November 1999 will cease to be exempt from tax from 1 July 2001. **Item 1 of Schedule 2** will extend the latter date to 1 July 2002.

Non-complying superannuation funds and Approved Deposit Funds (ADF)

Non-complying superannuation funds and ADFs are, basically, funds and ADFs which do not comply with the rules contained in the *Superannuation Industry (Supervision) Act 1993* and its regulations. Non-complying funds and ADFs receive no taxation concessions and are taxed at the highest marginal tax rate of 47%.

As noted above, from 1 July 2000 refunds have been available where there are excess imputation credits. As the company tax rate on which imputation credits are based is considerably lower (34% or 30%) than the rate paid by non-complying funds and ADFs, it would appear that non-complying entities would not be able to claim a refund of excess imputation credits. In a recent Press Release the Assistant Treasurer stated:

> However, it might be possible for such funds to enter into artificial schemes so as to produce surplus imputation credits.[3]

The Assistant Treasurer then announced that amendments would be made to deny refunds to non-complying funds and ADFs and that this was in line with the policy of providing 'tax concessions only for complying superannuation entities, where prudential controls provide some certainty that the concession will generate retirement income for individual fund members'.[4] It was also announced that the amendments would apply to the financial year of an entity containing the date of announcement (22 May 2001), thus for most entities which end their financial year on 30 June the changes will apply from 1 July 2000.

Item 2 of Schedule 4 will amend sub-section 67-25(1) of the ITAA97, which deals with the entities eligible to receive a refund, to specifically exclude non-complying superannuation funds and ADFs.

Application: For income years ending on or after 22 May 2001 (**item 5**).

Concluding Comments

In what is otherwise a non-contentious Bill, the main point of note is the potential retrospective operation of the provisions dealing with non-complying superannuation funds and ADFs.

Endnotes

1 Review of Business Taxation, p. 419.

2 *Explanatory Memorandum*, p. 23.

3 Assistant Treasurer, *Press Release*, 22 May 2001.

4 Ibid.